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SUBJECT: TURKEY EX-BANK GOVERNOR HOPES FOR AKP ALTERNATIVE

REF: A. ANKARA 6494

[¶](#)B. ANKARA 6403

Classified By: DCM Nancy McEldowney. Reasons 1.5 (b) and (d).

[¶](#)1. (C) Summary. Highly-respected former Central Bank Governor Surreya Serdengecti is pessimistic about the short-term outlook for Turkey's economy, which he sees reflected in the stubborn failure of the inflation rate to fall below 10% and a return of dollarization. He does not believe the AK Party government is committed to sound economic policies, particularly under election year pressure.

Current opposition parties do not offer a credible alternative, but Serdengecti, who is now working closely with TOBB President Rifat Hisarciklioglu, says a "third political force" committed to orthodox policies could emerge in the coming months. How much of this is wishful thinking is not clear, but it is clear that the business community's continued support for the AKP government depends on its ability to sustain pro-business policies. End Summary.

A Change in Expectations

[¶](#)2. (C) In a November 30 meeting at his new perch at Ankara's TOBB University, Serdengecti painted a negative outlook for the Turkish economy. He said his assessment was based on his meetings with businesspeople throughout the country as well as on the obvious difficulty the Central Bank is having controlling inflation. Private companies, he said, are forecasting 2007 inflation in a range of 7 to 10%, compared to an official target of 4%. He said changed expectations about the future, rather than higher energy and import prices, are reason behind the reversal in the trend that saw inflation steadily fall to its current level from over 70% in 2001. For the first time since the economic crisis, inflation has reached a "threshold" below which it stubbornly refuses to go. Another sign of insecurity is, he said, the reversal of the long-standing process of dedollarization. (The share of the money supply denominated in dollars and euros grew from 45% in May to 53% in November.)

[¶](#)3. (C) The change in expectations is shaped by Serdengecti's belief that the AK Party government is not committed to the sound economic policies that have driven the recovery. Evidence of this is manifold, but the Governor singled out the April-May controversy over the appointment of his successor as being the trigger that showed the AKP's true populist colors and altered the previously positive assessments of economic actors. The "unrealistic" 2007 budget (ref A), a large pay increase for public workers, and current speculation about pre-paying the IMF are other examples of how the government is seeking to escape from the

shackles of austere policy. The Governor is also worried about how the government will resolve what he sees as the very serious macroeconomic problem of intra-government debts (ref B).

"Not A Single Person" Committed to Reforms

¶4. (C) Of course, this is no surprise to Serdengecti, who has long been critical, in and out of office, of the AKP's commitment to sound public finances. Serdengecti insisted that "not a single person" in this government understands the importance of the 6.5% of GDP primary surplus target. Instead, what he called the "foreign exchange" and "export" lobbies collaborate in and out of government for a weaker currency and sectoral subsidies and protection. These populist forces are only held in check by the IMF program and EU accession process. Pointedly not mentioning Economy Minister Babacan, he said Treasury Undersecretary Ibrahim Canakci was the only senior person holding the IMF program together. Serdengecti said the IMF itself has become an increasingly absent force, while the AKP's commitment to EU accession is not genuine.

¶5. (C) Per Serdengecti, not since the days of Kemal Dervis (and presumably himself) has a senior figure been genuinely committed to economic reform. The main opposition Republican Peoples Party (CHP) is at least as bad as the AKP. Serdengecti, who is rumored to be working with Rifat Hisarciklioglu to advance the TOBB President's political ambitions, coyly suggested that a "third force" could emerge that would support liberal, orthodox economic policies. He said this could happen in Turkey in a period as short as six months.

Slow Election Year Growth to Add to Pressure

¶6. (C) The political outlook will also be clouded by a slowdown in growth that Serdengecti expected to begin in the second half of 2006 and continue into 2007. He said it was not clear what the political fallout would be if the growth rate fell below 5%, which seemed likely, but that this would add to the pressures on and within the AKP to break with IMF-supported policies. Carefully saying he had no information about pressures from other quarters, Serdengecti noted that the "secular/conservative establishment" had also been "encouraged" by the ease with which the military took control in Thailand.

¶7. (C) Comment: At the moment there is probably no better informed observer of the Turkish economy outside government than Serdengecti. His pessimistic vision may be colored by his treatment by the AKP and the lack of recognition he feels he has received for his impressive accomplishments in bringing down Turkey's inflation rate. His comments about inflation also ignore the fact that in his final months in office he too recognized that it would be a challenge to meet the 2006 targets. It also ignores the fact that inflation was stuck around the 8% level in the final months of Serdengecti's governorship.

¶8. (C) The hints of a new political entity emerging, with TOBB leader Rifat Hisarciklioglu likely to play a leading role, have been rumored for years but never seem to happen. Still, Serdengecti remains very plugged into the business community, including through his association with TOBB. As to whether Hisarciklioglu is the business world's savior in waiting, other senior business contacts suggest that they continue to give the AKP the benefit of the doubt, but it is clear that business support for the AKP is that of convenience and that it will only last as long as the AKP continues the non-inflationary policies that have spurred the economic recovery.

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